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HQ SOUTHCOM ALSO FOR POLAD  
TREASURY FOR MMALLOY  
NSC FOR JCARDENAS AND JSHRIER  
COMMERCE FOR 4431/MAC/WH/MCAMERON

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TAGS: ECON EFIN VE

SUBJECT: PRESSURE MOUNTS ON VENEZUELA'S EXCHANGE CONTROL  
REGIME

REF: CARACAS 2228

Classified By: Economic Counselor Andrew N. Bowen for reasons 1.4 (b) a  
nd (d).

¶1. (C) Summary: The BRV's exchange control system appears to be coming under increasing pressure, as a persistent and large gap between the official and parallel exchange rates makes acquiring dollars at the official rate the best business in town. Contacts note that CADIVI is falling further behind in processing dollar requests, and its web-based system for receiving requests has repeatedly crashed due to overwhelming demand. Processing delays may constrain import growth, as many banks have reached the limit on lines of credit that finance imports in advance of CADIVI's authorization for the disbursement of hard currency. Banks are also bearing the brunt of CADIVI's delay in authorizing funds to cover credit card purchases abroad. There is speculation that the BRV could move to a dual exchange rate system or restrict the scope of imports eligible for CADIVI dollars. We doubt, however, that the BRV would prove any more adept at managing a dual rate system than the current one. End summary.

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Endless Opportunities  
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¶2. (SBU) The official exchange rate, a fixed rate last adjusted by the BRV to 2150 bolivars (Bs) to the dollar in March 2005, has become increasingly overvalued, thanks in part to several years of double-digit inflation. The parallel market rate is currently at 5,600 Bs/USD, and it has been more than double the official rate for the past six months. Given the bolivar's overvaluation and the persistent gap between the official and parallel rates, anyone who can get dollars at the official rate is making a killing. Wealthy Venezuelans, for example, can send their children to top private colleges in the U.S. for just over one third the cost with "CADIVI dollars" (if a parent converted USD 10,000 into Bs at the parallel rate and turned those Bs over to CADIVI, the corresponding CADIVI dollars would pay for a tuition of USD 26,000).

¶3. (SBU) CADIVI, the BRV agency charged with authorizing disbursement of official dollars, only publishes total

dollars authorized for disbursement, not the total amount requested. We are sure, however, that the total requested has leapt astronomically this year. One of our contacts who executes parallel market transactions said recently that he was seeking to open several import businesses; his only lament was that everyone else seemed to have the same idea.

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CADIVI Overwhelmed  
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¶4. (C) Complaints from businesses about delays in obtaining authorization from CADIVI have intensified in recent months, and several other signs suggest that CADIVI is becoming overwhelmed with requests. Former CADIVI president Mary Espinoza (strictly protect) told econoff in mid-November that CADIVI's web-based system for receiving requests had been down for five days because so many people were trying to access it simultaneously. Business contacts have reported difficulties in accessing the system, and even CADIVI officials have publicly admitted to problems with the website. Some contacts have suggested that the delays are also due to corruption, with CADIVI officials reportedly "charging" a fee of 400 Bs per USD to process requests. With such a large gap between the official and parallel rates, one of our contacts joked, "CADIVI would corrupt even the Pope."

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Banks Reporting Increasing Problems  
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¶5. (C) Citibank Venezuela president Bernardo Chacin (strictly protect throughout) told econoffs that some banks had reached the limits of credit lines used to finance approved imports and were unable to finance new imports until CADIVI authorized disbursements for previously approved imports. (Note: CADIVI makes two key authorizations during the import process. It approves the import for hard currency disbursement before the import takes place, and it approves the actual disbursement of hard currency after the approved import takes place. Banks have to date provided financing to bridge the gap between the first and second approval, but as this gap increases they are increasingly reluctant to do so. End note.) Several banking sector contacts have recently noted that CADIVI has fallen behind on authorizing reimbursements for credit card purchases abroad. (Note: Venezuelans are allowed to make credit card purchases of up to USD 3000 per year at the official rate. End note.) Oscar Garcia Mendoza (strictly protect), president of Banco Venezolano de Credito, claimed that banks had fronted up to USD 1 billion to customers, for which they were waiting for CADIVI disbursement authorizations. (Note: It was unclear if this amount included both credit for imports and for credit card purchases, or only the former. End note.)

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BRV Response Piecemeal to Date  
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¶6. (C) The BRV has done little to address problems in the currency control system. The Minister of People's Power for Finance said on December 6 that the government was considering measures "to safeguard the system of administering hard currency" but gave no further explanation.

Also on December 6, officials from the Ministry of People's Power for Finance, CADIVI, and the Ministry of Food Supply met with banking sector officials to discuss problems in the system. According to Chacin, who was present at the meeting, the Vice Minister of Food Supply blamed the banking sector for delaying imports of basic foodstuffs by withholding credit.

¶7. (SBU) Contacts believe that the BRV could decide to establish a dual exchange rate, with the lower rate reserved for priority import items such as basic foodstuffs. Yet the only concrete step the BRV has taken to date has been to ask tens of thousands of individuals to justify their credit card

purchases, with potential punitive measures for those who abused the system and the "patrimony" of the state, as CADIVI's president put it. While the USD 3000 credit card allocation is a source of widespread fraud, it represents only 10 percent of total CADIVI authorizations.

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Comment  
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¶8. (C) The rate of growth in hard currency disbursements authorized by CADIVI, the majority of which go towards financing imports, is clearly unsustainable over the medium term. According to its website, CADIVI has already authorized 41 percent more through December 4, 2007 (USD 38 billion) than in all of 2006 (USD 27 billion). If these statistics are true, if CADIVI authorizations were to continue to grow at this pace, and if petroleum revenues leveled off at expected 2007 levels, CADIVI hard currency authorizations would exceed petroleum revenues in 2009 (even using the BRV's petroleum revenue figures, which we believe to be overstated - reftel).

¶9. (C) Implementation of a well-managed dual exchange rate system could in theory help alleviate bottlenecks in the import of priority items, reducing their prices (or eliminating shortages) and thus catering to Chavez' constituency. On the negative side, it would certainly be distortionary and would be equally open to corruption, as importers switched to priority items or bribed CADIVI officials to register their products as such. It might also prove inflationary, to the extent that merchants have not already set prices of "non-priority" imported items somewhere between the official and parallel rates. Finally, it would not solve the basic problem inherent in maintaining an

overvalued fixed exchange rate, namely that demand for hard currency will always exceed supply, forcing the government to manage the rationing process. We have no confidence that the BRV would prove any more adept at managing a dual exchange rate system than the current one. End comment.

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